DOCUMENT RESUME

ED 323 834 HE 023 814

AUTHOR	McPherson, Michael S.; And Others
TITLE	Federal Student Aid Policy: Can We Learn from Experience? Proceedings of the New York Education Policy Seminar (3rd, Albany, New York, October 1985). and Discussant Comments . Rockefeller Institute Conference Proceedings, Number 7, Spring 1986.
INSTITUTION	State Univ. of New York, Albany. Nelson A. Rockefeller Inst. of Government.; State Univ. of New York, Albany. School of Education.
PUB DATE	Oct 85
NOTE	30p.
AVAILABLE FROM	Marketing and Public Relations Dept., Rockefeller Institute of Government, 411 State St., Albany, NY 12203 ($3.00).
PUB TYPE	Collected Works - Serials (022) -- Speeches/Conference Papers (150)
JOURNAL CIT	Rockefeller Institute Conference Proceedings; n7 Spr 1986
EDRS PRICE	MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS	*Disadvantaged; Educational Economics; Educational Finance; Educational Policy; Enrollment; Federal Aid; Federal Programs; *Government Role; Higher Education; Low Income Groups; Need Analysis (Student Financial Aid); *Program Effectiveness; *Student Financial Aid; *Student Loan Programs
IDENTIFIERS	*Guaranteed Student Loan Program

ABSTRACT

This paper examines the problem of determining how effective student aid programs have been in promoting the college enrollment of lower income and disadvantaged students and analyzes the institutional means through which federal aid policies have been implemented. The importance of considering the key role of state and institutional responses to federal policies is stressed. The document discusses: enrollment effects of student aid, strategic Congressional choices, student aid versus institutional aid, tax credits versus aid expenditures, and guaranteed loans versus a loan bank. It is concluded that the decentralized, market-based approach of portable need-based grants has worked rather well, but the decentralized, market-based approach of running the loan program through banks has not worked well. Other successful features in student aid were Congressional decisions relying on student rather than institutional aid and on expenditures over tax credits; unsuccessful features included the Congressional decision to adopt a guarantee mechanism in the Guaranteed Student Loan (GSL) program. Finally, policy implications are identified, including the basic reconstruction of the GSL program, examination of various schemes to subsidize student costs through the tax side rather than the expenditure side of the budget, and rejection of a proposed legally mandated needs analysis system. Discussant comments by Ronald B. Hoskins and C. Mark Lawton are included. (DB)

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Conference Proceedings

Federal Student Aid Policy: Can We Learn From Experience?

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Michael S. McPherson
The Brookings Institution
and Williams College

Proceedings of the
New York Education Policy Seminar

Edited by **Alan P. Wagner**
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Comments by

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Number 7
Spring 1986

HE 023 814

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$2.00

Proceedings of the New York Education Policy Seminar

FEDERAL STUDENT AID POLICY: CAN WE LEARN FROM EXPERIENCE?

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October 1985
Albany, New York

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Preface

This publication is one of a series published by the School of Education and the Rockefeller Institute of Government. The paper and discussant comments were first presented at a School of Education/Rockefeller Institute *Education Policy Seminar*. The Seminar and this publication are intended to reflect the fundamental connection that professional schools must have between the world of ideas and discovery and the interaction between the world of problems to be solved.

Excellence in research encompasses many different kinds of activity and serves many different purposes. The School of Education is committed to research that advances the power of the individual disciplines to explain, predict, and define new problems while fostering critical resistance to exaggerated or particularistic claims on their behalf. The goal is to create new knowledge while also preserving and exploring the complexities of the field.

The liveliness and creativity of research depend on the long standing tension between the urge to advance disciplinary claims as far and as rigorously as possible, and the contrary urge to subject these claims to critical scrutiny among a variety of interdisciplinary considerations. For this reason, the School of Education has carefully fostered the tradition of interdisciplinary research that is responsive to the needs of both scholars and practitioners.

It is at the intersection of the disciplines and at the junction of problems of practice that schools of education must stake their reputation. In this context the objectives for the Education Policy Seminar are:

a. To provide a bridge between education as a field of study and the social and behavioral disciplines;

b. To provide an opportunity for policy makers to analyze educational problems through the lens of one or more of the social and/or behavioral disciplines; and

c. To provide a forum where the traditions of scholarly research in the pursuit of new knowledge and fuller understanding are focused on the task of enhancing the quality of life through education.

The format of each seminar includes the presentation of a paper by a leading scholar from an academic discipline. The author is charged with examining the field of education through the lens of his or her discipline for the purpose of trying to both inform and improve educational practice. The paper is then responded to by two or more discussants. The proceedings are edited by a member of the School of Education faculty.

As mentioned previously, the Education Policy Seminar is offered in cooperation with the Rockefeller Institute of Government, State University of New York. In this regard, we are particularly indebted to Warren Ilchman, Director of the Institute, for his interest, cooperation and generous support of the Seminar and publication of the proceedings.

Finally, we trust the reader will find this publication stimulating and we invite and welcome comments.

Robert H. Koff, Dean
School of Education
State University of New York at Albany

Editor's Introductory Notes

The most recent estimates place the share of New York's postsecondary education students receiving some form of non-family financial support--grants or scholarships, earnings from term-time employment, or proceeds from student loans--above 50 percent. The various federal, state, institutional, and private sources of aid currently provide $2 billion a year to students in New York; about two-thirds of this amount comes from federal programs. Yet, though the dollars loom large in the financing of postsecondary education in the state, the impact of student financial aid on the decision-making of public officials, institutional administrators, and students and their families remains a controversial and continuing topic of debate and study.

In "Federal Student Aid Policy: Can We Learn From Experience?" Michael S. McPherson reviews the accumulated experience with federal student aid programs in attempting to sort out the competing interpretations of their impact on rates of student enrollment, tuition pricing, and state funding for higher education. In light of this review, Professor McPherson goes on to evaluate the appropriateness of prior and current choices about the design of federal student aid programs. Although applied here to questions about student financial aid, McPherson's approach could be usefully adopted for evaluations of other policy interventions at the state and federal levels. The paper was presented at the Third Annual New York Education Policy Seminar sponsored by the School of Education and the Nelson A. Rockefeller Institute Of Government on October 17, 1985.

Michael S. McPherson, a Senior Fellow at the Brookings Institution in Washington, D.C., is a highly respected economist who has devoted considerable attention to higher education finance, enrollment, and faculty issues. His chapter, "The Demand for Higher Education," in *Public Policy and Private Higher Education*, is widely acknowledged to be one of the most thorough and competent assessments of what is known about enrollment demand and the effects of student subsidies. Professor McPherson is currently on leave from his faculty position in economics at Williams College. He serves on the Board of Editors of *Change* and is the co-editor of a new journal, *Economics and Philosophy*.

The presentation given by Professor McPherson was followed by two discussants. They are Professor Ronald B. Hoskins of the Rockefeller College of Public Affairs and Policy and Dr. C. Mark Lawton, President of the Commission on Independent Colleges and Universities. Discussants' papers are included in the proceedings.

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Federal Student Aid Policy: Can We Learn From Experience?

Micheal S. McPherson

The Brookings Institution
and
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Experience, we are often told, is the best teacher. But if that is so, we must at least admit that her lesson plans are not very clear. Federal student aid, along with other social programs introduced in the activist days of the Johnson and Nixon Administrations, has now been around long enough to provide a substantial record of experience. Increasingly we are being asked to decide what lessons can be drawn from that experience. Has student aid (or low income housing, or Food Stamps, or Medicaid) "worked"? Can we use our experience to make it work better--and preferably, given budgetary stringencies--work better for less money?

It's not so easy. It is surprising, and perhaps instructive, that more high quality analytical work was done on student aid in the years prior to the blossoming of the federal programs in 1972 than has been done since.[1] Apparently a relatively clean slate has its advantages. One can analyze the workings of programs in the pristine form of their imagined state. And, lacking real data, one can get by on plausible-sounding made-up numbers. Once the programs exist, however, the analyst is faced with actual programs that never fully embody the simplicity of the theoretical model and real data that are hopelessly contaminated by reality. At the same time, the analyst's attention is readily drawn to the little glitches and curlicues of the programs' actual operations, and away from the larger questions of purpose and design that motivated the efforts in the first place.

The problems of learning from experiences are in fact at least two-fold. One is the sheer opacity of experience. How can we hope to disentangle the effects of a particular government program from those of all the other variables that are changing at the same time--especially when the program itself is likely to be continually modified in response to interest group pressures and to the perceived effects it is having? Even large scale social experiments, useful as they are, can never fully reproduce the conditions of a permanent national program. What we require is Douglas Hofstadter's imaginary device, the "subjunctivision." This looks much like a regular TV with a video recorder attached. The important difference is that on the subjunctivision we can replay events with critical assumptions changed. We could, for example, see how the recent Redskins-Oilers game would have come out if the officials had correctly awarded the Oilers a touchdown on that controversial pass play. (Washingtonians would oppose this.) Or, by pushing some other buttons, we could see how that game would have gone if the teams were allowed five downs per series.

With this device in hand, we could go back and see how history would be different if Congress had supported institutional aid instead of student aid in 1972, or if it had decided simply to abolish the federal aid programs in that year. Lacking this device, we are instead thrown back on the resources of statistical analysis and of our imaginations in trying to see what difference the federal programs have made.

The second difficulty in learning from experience confronts us even when our understanding of that experience is adequate. That is the problem of modifying programs once they are in place. Bureaucracies quickly form around programs, and interested parties develop a firm grasp of the advantages of the status quo. Since any significant change will produce losers as well as winners, consensus politicians will tend to converge on leaving things where they stand. There is no need to belabor this point before an audience familiar with student aid policy.

These two difficulties in learning from experience--what might be called the *cognitive* problem of deciphering that experience and the *strategic* problem of implementing the lessons--are not as separate as I have implied. For

programs can be set up in ways that either encourage or discourage bureaucratic entrenchment and that makes it easier or harder to get information about their workings. When we think about program design prospectively, we need to look at programs not only from the standpoint of their capacity directly to achieve goals, but also from the standpoint of the capacity of the organizations they create to learn and to adapt over time. Richard Nelson among others has argued that increasing attention to this *procedural* or *evolutionary* dimension of policy analysis has been a most important development in recent years.[2]

In what follows, I want to explore some implications of this "evolutionary" or "institutional" approach to policy analysis for our thinking about federal student aid. I have two main topics. The first concerns the problem of determining how effective student aid programs have been in promoting the college enrollment of lower income and disadvantaged students. I will argue that that problem looks very different once the key role of state and institutional *responses* to federal policies are taken into account.

The second part of the essay looks more directly at the institutional means through which federal aid policies have been implemented. Over the years, Congress has made several key decisions about *how* students and their families would be aided. I'll examine some implications of those choices for the evolution of aid policy. Then follows a brief look at policy implications and some concluding remarks.

Enrollment Effects of Student Aid

Nearly everyone agrees that raising the college enrollment of lower income and disadvantaged students has been among the central purposes of federal student aid. It would certainly be a mistake to construe this as Congress' *sole* purpose in providing aid, since it's quite clear that at various times national defense, the needs of "middle income" students, and the financial health of colleges have also motivated Congressional actions on student aid. Still, the concern with aiding the disadvantaged is sufficiently clear and central that it is naturally the first place to look in trying to see if the programs have "worked."

When they have looked, analysts have been less than pleased with what they have found. The enrollment rates of lower income students have not shown any clear upward trend since the major low-income oriented aid program, Basic Education Opportunity Grants (BEOG, now Pell), was introduced in 1972. The picture, in fact, is quite mixed, as John Lee (1983) has shown in comparing data for 1974 and 1981. Among dependent students, lower income whites had substantial increases in college participation, but lower income blacks experienced an even sharper decline. Lower income female dependents shared in the general increases in female enrollment during the 1970s, while lower income male participation declined. For dependent students as a whole, participation fell substantially for those with family incomes below $7,500 (in 1980 dollars), and rose for those earning from $7,500-$12,500. Meanwhile, the participation rate of lower income independent students dropped substantially. It's hard to discern anything like a consistent movement toward more participation of disadvantaged students during the years when the federal student aid effort was most prominent.

The same sorts of results emerged from Lee Hansen's 1983 study, in which he examined changes in the participation rates of lower income and higher income students from the early to the late 1970s, using several data sources. As it is well know, he found little or no systematic change in the ratio of lower and upper income enrollments over that period. Hansen had been willing to go further than Lee in drawing policy implications from these findings. He concludes that the old programs have had little effect on advancing the important goal of equalizing educational opportunity.

Obviously, we need Hofstadter's subjunctivision to decide if this conclusion is warranted. We know that a good deal besides federal aid policy changed during the 1970s: the War in Vietnam ended (and with it the military draft), inflation rose and economic growth languished (at least in part as a result of the oil crisis), and markets for educated labor were flooded with unprecedented numbers of college graduates. It's not unlikely that some of these factors would have affected the relative participation of lower and upper income students.

The fact that federal aid served purposes other than aiding the disadvantaged creates further complications. After 1978, with the passage of the Middle Income Student Assistance Act, large portions of the Office of Education's student aid budget went to provide subsidized loans and (to a lesser extent) grants to students from families with above median incomes, tending to reduce the real levels of support for the less advantaged. Early in the seventies

important amounts of federal student aid were also distributed outside the Office of Education, through GI Bill payments to veterans and through payments to surviving children of social security recipients. The total amount of grant aid, taking into account all these federal sources, actually reached its real dollar peak in 1975-76, so that the picture of "little aid in 1972, lots in 1980" is misleading.

These complications make the simple "before and after" comparisons of Hansen and Lee suspect. Statistical manipulations can go part of the way to overcoming the difficulties, by introducing further variables to the analysis that "control" for the effect of factors other than changing levels of federal aid to lower income students. That is what's accomplished by the econometric literature on enrollment demand. This literature produces estimates of the effects of price changes at colleges on the propensity to enroll, while controlling for other factors that may vary with the price. By assuming that the effect of a grant is the same as the effect of a price cut of the same size (or, in a few cases, by relying on direct estimates of the impacts of grants), we can estimate what effect the federal BEOG program would have had on lower income enrollments, in the absence of complicating factors like wars ending and other aid programs expanding and contracting. I have estimated elsewhere, using this approach, that the availability of Basic Grants should have boosted enrollments in the lower income population by 20 to 25 percent, compared to what they would have been otherwise.[3]

This sort of statistically corrected estimate is certainly helpful, but misses an important further dimension or complexity in trying to replay the past. It tries to determine what effects the Pell program would have had if various disturbing factors had not intervened. However, in order to do so, it makes the ruthless assumption that the *only* effect the grant program had was to reduce the net price facing students. The implicit assumption is that other aspects of state and institutional behavior, such as pricing, levels of state budgetary support, offers of institution-based aid, and so on, are unaffected by federal policy change. We would presumably want our subjunctivision to be more imaginative than that!

A lively illustration of this further dimension of complexity can in fact be drawn from New York State. An alert reader of the *Chronicle of Higher Education* noticed a recent story in which the Chancellor of the City University of New York objected to the Reagan Administration's plans to shift the burden of higher education finance toward the states. The reader reminded us that one of the recommendations of the Keppel Task Force report of 1972 was to introduce tuition at the City University in order to capture more federal student aid funds. He quoted the report as emphasizing that "New York State students and institutions will fail to some degree to quality for federal funds under the new statutes unless the public institutions charge higher tuition than they do at present....[We] consider it extremely important that the State take maximum advantage of federal funding in order to reduce the burden on state taxpayers."[4]

There is nothing at all nefarious about proposing to take advantage of changing federal rules in this way; indeed, it would be extremely odd, and probably irresponsible, if state governments and both public and private institutions of higher education failed to consider changing their own operations in response to changing federal student aid policies.

But to understand the effects of federal aid policies, it is clearly necessary that these indirect responses be taken into account.[5] The examples of such indirect effects that come most readily to mind (at least to one trained as an economist) are ones, like this, that tend to *offset* the effects of the aid. Others of the same sort might include hikes in private tuition, or reductions in institutions' own expenditures on aid. But plainly not all the effects work in that direction.

It's clear, for example, that the availability of federal aid makes it easier for both state and private institutions to pursue policies that encourage the admission of lower income students. Recruiting such students becomes less costly if the federal government pays part of their maintenance and tuition costs. It's even possible that the availability of federal aid could induce some institutions to devote *more* of their own aid resources to needier students, because the federal aid may lower to a more feasible level the gap that the institutions' own resources have to fill.

Sorting these potential effects out, and weighing their magnitude, is a major empirical/analytical project, one that I am currently trying to make some progress on. I can offer here some preliminary hypotheses and conclusions.[6]

1. Despite the Keppel Task Force's hopes, and Secretary of Education Bennett's frequently

voiced fears, there is not much evidence that the availability of federal student aid has lent a substantial upward push to higher education prices. Superficially, federal student aid arrangements look a lot like third party medical care payment schemes, where the provider can get more money from the government or the insurer simply by raising the price. But, in fact, most student aid doesn't work that way. For the most part, the size of a student's Pell grant or of a campus's allotment under the campus-based programs is determined by a formula that is insensitive to price.[7] In fact, as Table 1 shows, college costs rose considerably faster (relative to inflation) in the 1960s, when federal aid was small, and in the 1980s, when it had been falling, than in the 1970s, when it grew. This evidence is hardly conclusive, but it should give pause to those who see federal aid as a major source of higher education cost inflation.

Table 1. Annual Real Rates of Increase in Costs of Attendance at Selected Categories of Colleges and Universities, 1963-83

Year	Private University	Public Four-Year College	Community College
	(percent)	(percent)	(percent)
1963-70	2.2	1.5	3.2
1970-80	-0.5	-0.8	-0.9
1980-83	6.3	4.6	2.6

Source: Donald A. Gillespie and Nancy Carlson, *Trends in Student Aid: 1963 to 1983* (Washington, D.C.: Washington Office of the College Board, 1983) and Gillespie and Lynn Quincy, *Trends in Student Aid: 1980 to 1984* (Washington, D.C.: Washington Office of the College Board, 1984).

One exception to the general price insensitivity of most federal aid is worth noting. Under rules that have been in effect since 1982, the amount of subsidized loans that some higher income students are eligible for rises with the cost of the college they attend. It is possible that this link is connected to the recent rapid run-up in charges at private colleges.

2. It's very clear that efforts to recruit minority and disadvantaged students increased substantially in the 1970s, continuing a trend begun in the 1960s. In the public sector, this took the form largely of the creation of new "open-access" institutions, mostly community colleges; while at private institutions and many public four-year colleges revised admissions criteria, affirmative action programs, and curricular revisions were more important.

It's hard to show a cause-and-effect link between expanded federal aid and expanded recruitment, but it is clear, as noted above, that federal aid reduced the costs to schools of pursuing these policies. In the case of public community colleges, for example, the federal government went from supplying seven percent of their educational revenues in 1968 to supplying fifteen percent in 1979, with most of the increase being due to Pell.[8] This shift in financing may well have encouraged states to increase the supply of places at these institutions.

3. The most provocative statistical relationship I have discovered concerns the relationship between federal student aid and institutions' use of their own resources for aid, whether through price discounting or direct expenditures. As Table 2 shows, inflation-adjusted aid per student grew by more than five percent per year in both public and private institutions from 1966 to 1973, the period just preceding the introduction of BEOGs. From 1973 to 1980, it fell by seven percent per year in public institutions and by three percent per year in private

Table 2. Institution-Based Scholarship Aid
Selected Years, 1966-1982[1]

Year	Current Dollars			1967 Dollars			Per Student,[2] 1967 Dollars		
	All	Public	Private	All	Public	Private	All	Public	Private
1966-67	429	156	273	441	160	281	69	37	138
1969-70	701			638			80		
1972-73	1,067			851			92		
1973-74	1,133	537	596	851	403	448	89	54	205
1974-75	1,196	581	623	810	393	422	79	49	189
1977-78	1,526	718	825	841	396	455	75	45	187
1978-79	1,600	717	909	819	367	465	73	42	188
1980-81	1,831	779	1,079	742	316	437	61	33	166
1981-82	2,138			785			63		
1982-83	2,333			806			65		

1 Total institutional scholarship expenditures less supplemental educational opportunity grant revenues, as reported by institutions in the Higher Education General Information Survey and by the Department of Education's Office of Student Financial Aid.

2 Total scholarship aid divided by total enrollment (including graduate and part-time).

Source: National Center for Education Statistics, *Financial Statistics of Colleges and Universities*, various years, *Digest of Educational Statistics, 1983-84*, and Office of Student Aid, *OSFA Data Bank*, various years.

institutions. Total real spending on institution-based aid was lower in both sectors in 1980 than in 1973. Although detailed data are not available for the most recent years, it appears that real spending on institution-based aid has begun to grow again in the 1980s as federal aid has been cut back. Anecdotal information suggests that the growth in institution-based aid is currently quite rapid at many private institutions.

These changes, especially at private institutions, are large. Had real per student spending on institution-based aid at private colleges continued to grow from 1973 to 1980 as it had earlier, spending per student would have been higher by $344 (1980 dollars) in 1980 than it in fact was. This compares to Pell grants per student in private higher education of $544 in 1980.[3]

Again, many factors other than student aid policy were at work over this period, but the pattern present in these numbers is highly suggestive. The most straightforward interpretation is that institutions cut back on their own aid efforts as the federal government expands its aid. That interpretation, however, raises as many questions as it answers, for example:

- Could institutions have found the resources to fund expanded levels of aid in the 1970s, had the federal government not intervened as it did? The response by institutions might instead have been to cut back on their commitment to need-based aid, with the resources instead used for other purposes--perhaps merit aid or perhaps activities unrelated to student finance.
- If institutions had continued to expand their aid budgets during the 1970s at the rate they did in the 1960s, who would have borne the costs of greater aid? The most obvious possibility is that other students and their families would have, in the form of more rapid increases in tuition. There may in this sense be a link between the historical pattern of aid expenditures and of tuition. When federal aid resources are rising, tuition increases

may slow, because the cost of expanded aid is picked up by the national government. But when they are low or falling--as in the late 1960s and in the 1980s--tuitions may have to rise to finance increased aid from institutional revenues.

- Would institutions have directed aid to the same set of students the federal government did? Even if institutions continued to aim their dollars at needy students, they might have distributed them differently than federal programs did.

  One possibility is that institutions competing for students might have diverted their aid budgets toward "low need" middle class students, for whom relatively small awards might make a real difference in choice of school. This would have restricted opportunities for needier students, relative to the outcome with federal intervention.

Plainly much more work is needed in investigating the character of the linkages mentioned here and other possible ones. But it does appear that awareness of these institutional relationships may lead us to think about the role of federal aid policy in a somewhat different light. The U.S. Congress does not, after all, have the power within our federal system to directly *put* low income students into college. All it can do is try to direct the flow of federal funds in ways that permit and encourage the other actors in the system--states, colleges, and families--to move in that direction. From that perspective, a more accurate description of the aim of federal student aid policy embodied in BEOGs (and the campus-based programs) would be this: to bolster the market stability and financial health of postsecondary institutions that encourage the enrollment of lower income and disadvantaged students.

This interpretation is consistent with the legislative history of the 1972 Amendments, where Congress seemed to display almost as much concern with the financial plight of colleges as with the plight of disadvantaged students.[10] This interpretation of Congressional intent also suggests an interpretation of the developments in the 1970s and 1980s which plays rather well, at least on my "subjunctivision." It goes like this:

During the latter part of the 1960's, both public and private institutions undertook major efforts to provide expanded educational opportunity for needy and disadvantaged students. In the private sector, these efforts took the form of the expansion in need-based aid already noted and in programs for recruitment of minority and disadvantaged students. There was also an expansion of need-based aid in public higher education, but the development of community colleges and other open-access institutions, often in urban areas, was probably more important to the public effort.

Although data on student income distributions for those years are weak, there is some evidence that these efforts had a real effect. Davis and John's (1982) analysis of data from the ACE survey of freshmen suggests that the percentages of freshmen from families below the U.S. median income jumped between 1966 and 1971--by 35 percent at various categories of private four-year colleges, and by somewhat lesser amounts at public and private universities. Since then, these percentages have been roughly constant.[11]

Perhaps colleges and universities overreached themselves in making these efforts in the late 1960s. In response to a climate of opinion in the 1960s that greatly valued efforts toward more equality, they may have undertaken efforts they couldn't--or anyway wouldn't--sustain at growing cost in the longer run. As noted earlier, there was considerable concern at the end of the 1960s about the financial viability of many private colleges as well as about the fiscal capacity of state governments. Without federal support, private colleges might have backed off their commitments to recruit and help finance the education of disadvantaged students, and state governments might have backed off their commitments to support open-access institutions. If so, federal intervention may have had the effect of sustaining the gains made in the late 1960s, in the face of financial pressures that would otherwise have eroded them. The fact that low income and minority enrollments have declined in the 1980s, as federal support has been cut back, provides circumstantial evidence in favor of this interpretation.

This story is consistent with Lee Hansen's and John Lee's "before and after" data for the 1970s, but it would lend those data a very different normative significance than Hansen provides. For it would suggest that the federal programs, rather than *failing* because they failed to raise enrollments, instead *succeeded* by preventing lower income enrollments from falling.

This story is conjectural, but it does, I think, provide a suggestive interpretation of the recent past. Of course, even if the story is completely right, it by no means provides a blanket justification for existing federal student aid policies. Perhaps other feasible policies would have been more effective in moving institutions in the directions Congress desired, or in accomplishing results more cheaply. Such policies would, however, need to be analyzed in light of the kinds of institutional interdependencies noted here.

Strategic Choices: Replaying the Past

One way to get a handle on the consequences of alternative policies is to think back over major policy alternatives Congress has actually entertained, and to try to imagine (the subjunctivision again) what differences the choice of these other alternatives might have made. It's especially important, as was noted at the outset, to compare alternative policies in terms of the capacities of the organizations they create to learn, to adapt, and to yield up information about their performance.

In schematic terms, Congress can be said to have made three fundamental choices over the last twenty years that have shaped the existing structure of federal student aid. First, chronologically, in 1965, Congress decided to embark on providing federal support for subsidized educational loans by working through private financial markets rather than through a government supported "Student Loan Bank." Second, in 1972, Congress chose to expand its commitment to support of higher education through creating a program of grants to lower income students (the BEOG program) rather than through providing direct operating subsidies to colleges and universities--subsidies that were at that time being actively sought through the major higher education associations. Finally, in 1978, Congress elected to respond to strong pressure to subsidize the college costs of "middle income" students by extending the availability of need-based grant and loan aid to more affluent students, rather than by providing tax credits for college tuition. I will argue that the latter two choices were fundamentally correct ones, but that the 1965 decision to work through private loan markets has turned out to be an important mistake.

Student Aid vs. Institutional Aid

The decision to channel most aid to students rather than to provide direct federal subsidies to institutions implied allowing the educational marketplace to determine where federal subsidy money would go.[12] One of the influential early discussions of the institutional aid alternative identified a fundamental organization defect in the notion: "It will probably be concluded that a formula is a good device if it does not lead to a relative decline in the importance of any class of institutions. Consequently, one of the disadvantages of institutional aid by formula is that it encourages the status quo. Clearly, a system which tries to maintain the relative shares of different types of institutions will not be particularly adaptable to the changing needs of students and society in general" (U.S. Department of Health, Education and Welfare, 1969, p. 26). In principle, either a discretionary commission (like the University Grants Committee in Britian) or a sufficiently ingenious and complex formula for distributing aid could avoid endorsing the status quo, instead directing institutional behavior in desired directions. However, besides the political difficulties of establishing any such apparatus in so decentralized a system of institutions as the U.S., the informational requirements would likely prove unmanageable. It's hard to imagine a system of institutional aid at the federal level which would generate reliable information about what activities the aid was supporting and how effective the results were.

By contrast, direct aid to students gives institutions a straightforward incentive to respond to those students' demands. Students voting with their feet can over time reshape the mix of institutions substantially. At the same time, such aid can be targeted at lower income students and thereby help to promote more equal opportunity.

Perhaps the most striking consequence of strengthening the influence of lower income students through providing them with direct aid has been the rapid growth of the proprietary (for profit) sector in postsecondary education. Proprietary schools, which received less than seven percent of Pell grant funds in 1974, received 18.9 percent of those funds in 1984, more, in fact, than public two year colleges received (Lee, 1985, Table 3). We may well feel ambivalent about this result. Presumably it reveals that these students obtain something valuable from the proprietaries which they wouldn't have gotten (and which we wouldn't have known about) without the existence of portable aid. On the other hand, we know relatively little about many of these institutions

and have suspicions about the educational value of some, and, as they grow in importance, we may with justice want to see them brought within a more adequate regulatory structure. Despite this ambivalence, the emergence of the proprietaries is a good illustration of the way portable aid to students encourages innovation in education and makes the system responsive to student preference.

It's worth stressing that these criticisms of institutional aid at the federal level do not necessarily carry through for the states. States for the most part operate the institutions they finance and thereby gain greater control over the uses to which subsidies are put. Also, because most states provide operating subsidies to only a limited number of institutions, the informational and incentive problems noted above may be less acute.

Tax Credits vs. Aid Expenditures

In 1978, the Carter Administration concluded that the only way to head off a bill providing tax credits for college tuition was to support the extension of student aid to middle and upper middle income students. The resulting Middle Income Student Assistance Act removed all needs tests from the Guaranteed Student Loan Program and made the needs test in the BEOG program substantially more generous. The result was a rapid and substantial shift of student aid funds toward students from families with incomes above the median.

In retrospect, it seems clear to most observers that this was a bad piece of legislation.[13] It disrupted the traditional commitment of aiming student aid subsidies predominantly toward lower income families. Moreover, the unrestricted availability of heavily subsidized loans encouraged even families with no shortage of funds to borrow, if only to take advantage of the interest rate spread by reinvesting the proceeds. Besides the concerns about equity these issues raised, it rapidly became apparent that the budgetary commitments implicit in that legislation would lead to large and continuing increases in the student aid budget, increases that were probably unsupportable.

Despite these important drawbacks of the 1978 legislation, it seems clear that from an evolutionary point of view that legislation was superior to introducing tax credits. For one thing, the embarrassing consequences of the legislation that passed were highly visible--in rapidly increasing budgetary costs and in aid awards to affluent students. Indeed, in the years since 1980, the extensions of aid to higher income students have been largely reversed through further legislative action. Had tax credits been introduced instead, both their budgetary costs (in terms of foregone tax revenue) and their distributional implications would have been much less visible. Because tax measures generate less information about their functioning, they are less prone to correction over time. In fact, it seems likely that once tax credits for college expenses were introduced, the pressures to increase their amounts and to broaden whatever income restrictions they began with would prove irresistible.

In these two basic respects, then, focusing on supporting students rather than institutions and relying on the expenditure rather than the tax side of the budget, existing federal higher education programs seem well structured.

Guaranteed Loans vs. A Loan Bank

However, in deciding to operate the principal federal loan program for higher education through private financial institutions, Congress may well have made a strategic mistake. This financing mechanism has in fact plagued the Guaranteed Student Loan (GSL) Program since its inception.[14] The basic strategy of the program has been to encourage banks to lend money to students by insuring those loans against default, and to encourage students to borrow by having the government pay their interest costs while they are in school (and in certain other special statuses).

Ironically, for the first decade of the program's existence, its major problem lay in getting banks to make enough loans. Students were wary of borrowing; banks, unfamiliar with the loans and put off by what they saw as high administrative costs and doubtful profitability, were reluctant to lend; and states, who were supposed to help oversee the program, saw little advantage in becoming involved. Loan volume, especially to minority and disadvantaged students whom lenders might see as less desirable, was much less than desired.[15]

We have, it would appear, fixed that problem. This has been accomplished, essentially, by *paying* everybody to participate: banks receive a "special allowance" from the government that guarantees them a return above their cost of funds; the interest rate students pay is set below market rates, and state agencies that administer the loans have received administrative cost allowances and interest free loans from the government to encourage their cooperation.

From the point of view of establishing an institutional structure with the potential to evolve in a constructive way, these arrangements have very serious drawbacks. First, it is extremely hard to tell, with this set-up, where all the federal money is going, and whether the payments are justified. There is no market test of whether the current level of payments to banks is needed to make the student loan business profitable for them, nor of whether the payments to state agencies are required.

Second, the system sets up perverse incentives for all the actors. Because banks and state agencies are essentially fully insured against defaults, they have no financial incentive to try to collect loans. Although the program gives the appearance of being market based, since it operates through profit-making financial institutions, efforts at collection of loans by banks and agencies are in fact induced not by the market but by regulatory "due diligence" requirements, which have become increasingly elaborate over time. Meanwhile, the subsidy offered to students tends to encourage them to borrow more than they need to finance their education; the response to this is still another set of regulations that limits loan amounts and restricts loan eligibility to the needy.

A third drawback is that the system discourages innovation in such matters as repayment periods and the introduction of variable repayment schemes. The key elements of the loan agreement are in effect written into the law, by the rules according to which the government distributes subsidy payments. Not only is it cumbersome to modify these legislated rules; the complex set of interests created by the subsidy structure makes it very hard to arrive at an agreement for any change.

Finally, and importantly, the current set-up introduces a bias in Congressional deliberations about aid. Congressional budget practice implies that only current outlays on loans appear in the budget Congress deals with; the contractual commitments the government undertakes when new loans are granted do not register on the books until they come due. As a result, any curtailment of new guaranteed loans has only a minor short term effect on the budget. Most of the budgeted costs of the loan program for the next few years are to pay the costs of special allowances, interest subsidies and defaults on past loans. By contrast, reductions in grant awards show up as immediate budgetary savings. As a result, the real value of aid awarded to students from programs other than GSL has been dropping rapidly under the recent pressure to cut federal expenditures--it is now less than half what it was in 1978. During the same period, the inflation adjusted value of GSL aid has grown by 285 percent.[16]

It seems likely that other institutional arrangements for college lending would have fared better than GSL has done. Not that all the problems would have disappeared. GSL interest rates were originally set at more or less unsubsidized levels; the rise in interest rates that accompanied inflation at the beginning of the 1970s began the pattern of subsidy to both banks and students who were repaying loans.[17] That unanticipated run up of interest rates would probably have pulled any federal lending program at least temporarily into giving subsidies.

However, some version of a national Student Loan Bank would seem to have advantages both in providing more information about how the program was performing and in giving it the potential to learn from and adapt to experience. Such a bank would be empowered to borrow at government rates and lend (presumably through colleges and universities) to qualified students. The bank could be expected to set rates to cover its costs, including the insurance of defaults. If instead a subsidized loan rate were desired, the cost of that subsidy would show up as an operating loss of the bank, which would have to be covered from federal appropriations. It would be relatively easy to gauge the extent and identify the beneficiaries of the subsidy. Such a bank could also be given considerable latitude to experiment with alternative financing instruments and terms for college lending.[18]

The decision to rely on private financial institutions rather than a national bank to finance educational loans may by now be irretrievable. The existing system has a formidable list of constituencies on its side. Banks and state agencies have a direct interest in the present system, while schools and students may prefer "the devil they know." Still, unless some basic restructuring is done, it seems likely that these important structural problems will persist, and will increasingly dominate federal decision making about student aid. Perhaps the best hope is to develop some incremental strategy for "weaning" the system of its dependence on GSL, perhaps as Arthur Hauptman has proposed, through expanded reliance on a modified form of the direct lending mechanism embodied in the existing small National Direct Student Loan Program (Hauptman, 1985).

Summary

Is there any general lesson to be drawn from this schematic review of history? One, perhaps, is to beware of general lessons. It's often said, for example, that we should rely on the market as much as possible, and prefer decentralized to centralized solutions to problems. But, while the decentralized, market-based approach of portable need-based grants has worked out rather well, the decentralized, market-based approach of running the loan program through banks has not worked well at all--worse, in all probability, than a more centralized National Bank, using schools as lending agents, would have done. In general, as Nelson and Winter have observed, "serious policy analysis [in areas where many actors are involved] requires detailed understanding of the institutions, mechanisms, interests, and values at stake" (Nelson and Winter, 1983, p. 385). Close analysis has to substitute for easy generalization.

A second lesson may be of more comfort. Both the decision to rely on student rather than institutional aid and the decision to favor expenditures over tax credits were the product of deliberate and extended debate in Congress and among the informed public. By contrast, the decision to adopt a guarantee mechanism over other possible forms of lending was apparently taken much more casually. GSL started as a small and not heavily subsidized program, and full blown proposals for a National Student Loan Bank were not developed until the late 1960s, when GSL already existed. We might conclude, then, from this admittedly small sample of Congressional actions, that Congress performs better when it deliberates more fully--a result that might strike some as counter-intuitive.

Some Policy Implications

My main purpose in presenting this analysis has been to suggest some constructive ways of looking at student aid policy, rather than to defend detailed policy proposals. Still, it may advance the discussion if I spell out some policy implications that seem to me to follow naturally from the prospectives developed here.

1. Need-based portable grant assistance to students continues to look like the most attractive vehicle for carrying the main burden of federal subsidies to undergraduate education. The case that such assistance "doesn't work" in promoting the enrollment of the disadvantaged has to be judged "not proven." Given the institutional complexities and the limited state of our knowledge it's hard to "prove" this case one way or the other.

However, if Congress wants to help finance the colleges, and wants to do it in a way that encourages the system to respond to the needs of disadvantaged students, need-based grants are a more effective and institutionally manageable way to do it than any alternative that has been suggested. This broad conclusion of course leaves plenty of room for detailed debate about the desirable level and terms of grant subsidies. The pressing concern here is that the real level of Pell grant awards has lagged very badly behind rising college costs (the current $210 maximum is worth only about three quarters as much as the $140 maximum in effect in 1975). It seems quite likely that this is part of the explanation for the sharp recent drop in minority enrollments in college. Getting grant awards back to the real levels of the mid-1970s--perhaps at the expense of loan funding--is an important priority.

2. The Guaranteed Loan Program is in need of basic reconstruction. For the reasons set out above, the financing mechanisms established in that program do not work well. Converting the system to a more straightforward and manageable arrangement like a National Loan Bank makes basic sense. I should stress that I do not base this conclusion mainly on the currently popular concerns about defaults or about excessive loan burdens. Both of these are in important measure by-products of the more basic failings of present arrangements, and would be helped by an institutional set-up that gave lending institutions an incentive to collect loans and to devise more flexible and longer term repayment arrangements.

The short-term defect in the GSL program that I would be most inclined to stress is the large federal subsidy cost of the existing program--the product more of interest subsidy than of default costs. It's quite unclear who benefits from this subsidy or what social goals it promotes, and the growing federal cost starves other, probably more important, aid programs like Pell. In the longer run, perhaps the most serious defect with the guarantee program is precisely that it discourages "learning from experience"--despite its apparent decentralization, it's not a set-up that invites, or even permits, much experimentation, innovation, or response to changing conditions.

3. The idea of formula-based institutional aid as a substitute for federal student aid is perhaps permanently dead (and little mourned),

but the notion of subsidizing student costs through the tax rather than the expenditure side of the budget lives on. The currently most popular notions are not tax credits for college tuition but various schemes to provide tax breaks for college savings. Each such scheme must be looked at on its own merits, and some of them may have features that make them superior to the simple tax credit notions of years past. Moreover, increasingly widespread tax support for other uses of savings--including retirement, home ownership and life insurance--may create a "second-best" argument for extending such support to educational saving as well.

Still, all tax subsidy schemes suffer from the important institutional drawbacks identified earlier. With both their costs and their consequences less visible than expenditure programs, they are less likely than expenditure programs to receive careful oversight or to evolve in constructive ways.

4. An issue has surfaced in the current debate over reauthorizing the Higher Education Act which raises in a sharp way the concerns expressed in this paper about fostering constructive change and adaptation. In the past, Congress has elected to leave considerable scope for non-governmental groups to develop systems for computing the financial need of applicants for aid other than Pell grants (Pell awards have already been determined by federal formula). There appears now to be a strong possibility that Congress will write into the law a detailed needs analysis system to apply to *all* aid (including state and institution-based aid) going to any student who receives any federal aid at all.[19] The current rules instead allow organizations like the American College Testing Service and the College Scholarship Service to develop their own needs analysis systems, which they then provide to colleges, as long as the systems conform to broad federal guidelines.

A legally mandated needs analysis system would be a regrettable step toward rigidity. Needs analysis, especially for the relatively affluent students who may be eligible for aid at higher cost schools, is a complex affair. Systems must be revised over time to account for inflation, for changes in tax laws, and for other developments. Preserving equitable treatment requires difficult judgments about matters that are both technical and emotionally charged--like taxing home equity, farm assets and tax-sheltered income--matters that are politically hard for Congress to deliberate about and mechanically difficult to write into law in a timely way. Meanwhile, over the last five years, the existing needs analysis systems have been evolving toward a more comprehensive and coherent assessment of family finance.[20]

Although in the short run this is a fairly small and rather technical element of the student aid debate, it could eventually prove consequential. For if, as I think likely, a legally mandated needs analysis formula becomes in time both obsolete and heavily politicized, it could tend toward undermining the credibility of the student aid system as a whole.

Conclusion

When my son was six, he would often embark on projects of rather striking ambition--usually drawings of mural size. After some minutes of intense effort, a difficulty would arise, and he would dissolve in frustrated tears, abandoning not just that drawing, but the very *idea* of making drawings--or indeed of trying things in general. Our politics at the moment have a little of that flavor. Exaggerated hopes in the 1960s have led to exaggerated disappointments, and too sweeping reactions, in the 1980s. We're prone, I think, to ask overly simple questions ("Did the Great Society succeed or fail?", "Does Student Aid work?") and to demand overly conclusive answers.

Constructive social policy requires instead greater awareness of the complexity of social institutions and consequently of the limitations as well as the strengths of the analytical tools we can use in assessing policies. We need the patience both to ask less sweeping questions and to expect complacency: we also need to remain honestly critical of the shortcomings of our policies and institutions. I have tried in these remarks on student aid to embody something of this approach, one that I think is essential if we are to "learn from experience."

I'm happy to report that my son, who's just turned nine, seems to be learning to moderate his cycles of overambition and excessive despair. With luck, our society will do the same.

Notes

The author acknowledges support of the Andrew Mellon Foundation for the research underlying this paper. Mary Skinner assisted in research, and Meropi R. McCoy did the text processing. The views expressed are those of the author and should not be attributed to other staff members, officers, or trustees of the Brookings Institution.

1. An entire issue of the *Journal of Political Economy* a leading economic journal, was devoted to higher education finance in 1972. Proposals for income-contingent loans generated substantial analytical work (Shell, 1968, 1970; Dresch and Goldberg, 1971, 1972; Hartman, 1971). The Joint Economic Committee of the U.S. Congress also published a volume of studies on higher education finance in 1969.

2. See Nelson (1977) and Nelson and Winter (1982). Another volume in a similar spirit is Lindblom and Cohen (1979).

3. See McPherson (1985). The estimate is for 1979, relying on a "consensus" estimate of price sensitivity of enrollment reported in Leslie and Brinkman (1985).

4. Letter from Russell I. Thackrey, Manhattan, Kansas, in *Chronicle of Higher Education*, June 26, 1985. The quotes are from pages 5 and 15 of the report (Task Force on Financing Higher Education, 1972).

5. To draw an analogy to the football game viewed on subjunctivision, neglecting these indirect effects would be like seeing what happened if one team changed its offensive strategy and the other stuck to its old defense.

6. A fuller discussion of some of these findings is in McPherson (1985), on which the following pages draw in part.

7. The exception, which the Keppel Task Force had its eye on, is the provision in the Pell program that limits a student's maximum award to half the cost of attendance. A low-cost college with many students up against that ceiling could garner added federal resources simply by raising its price. In fact, however, the other limits on Pell awards have lagged so far behind inflation in college costs and other prices that for some time there have been few schools in a position to take much advantage of the provision by raising their prices. The formulas for dispensing "campus-based" aid to institutions are in principle cost-sensitive, but in reality they are so heavily "grandfathered" that at current funding levels the cost sensitivity is lost.

8. Calculated from data in Gillespie and Carlson (1983), and U.S. Department of Education, National Center for Education Statistics (various years).

9. All per student figures are per total enrollment, including graduate and part time. Undergraduate full-time equivalent enrollment data are not available for some years covered in the data.

10. See Gladieux and Wolanin (1976). Readers will recall that concern about the financial stability of colleges, especially private colleges, was quite widespread around 1970. The most influential of the reports that appeared at that time was Cheit (1971).

11. The Carnegie Council (1979) reports a similar trend based on Census data.

12. Congress has continued to provide small amounts of institutional aid for library expenditures, for "developing institutions," and in some other ways. The relatively small "campus-based" aid programs, which give money to institutions to provide to needy students, are somewhere between institutional and student aid. But in the discussion leading up to the 1972 Education Amendments there was serious consideration of large scale, formula driven operating subsidies to be provided to all colleges and universities. It was this alternative to expanded student aid that Congress turned away from.

13. A valuable volume in the Carnegie Council series (Carnegie Council, 1979) was devoted to proposals aimed at undoing the negative effects of that legislation.

14. The National Defense (later Direct) Student Loan Program (which predates GSL) provides federal capital directly to colleges to use in making loans. It is much smaller than the GSL program.

15. These problems are examined in Rice (1977).

16. Computed from data in Gillepsie and Carlson (1983) and Gillespie and Quincy (1984).

17. The in-school interest subsidy was always part of the program for needy borrowers.

18. Helpful recent discussions of the Loan Bank notion are in Carnegie Council, 1979, Chapter 13, and Hauptman, 1986 [draft].

19. The wide reach of this system would apply because of the so-called "overaward" rule--no student who receives federal aid can receive a total aid package that exceeds his or her demonstrated need.

20. This judgment is based largely on my service for several years on the College Scholarship Service's Committee on Standards of Ability to Pay--which service may, however, have biased my perception of this issue.

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Comment by Ronald B. Hoskins

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We often hear arguments in favor of the increased use of market incentives in lieu of institutional arrangements for achieving the government's public policy objectives. Michael McPherson's insightful analysis of strategic decisions in federal student aid policy clearly advances our appreciation for the complexity of evaluating public policy choices but seems at first to contribute contradictory evidence to the muddled debate over the effectiveness of the commercial market strategy as a tool for successful policy implementation.

On the one hand, McPherson's replaying of the past leads to the conclusion that the commercial market strategy has been generally successful in achieving the policy goals of the Basic Educational Opportunity Grants (BEOG, now Pell) Program and the Middle Income Student Assistance (MISA) Act. His reinterpretation of the BEOG data using the power of "subjunctivision" suggests, contrary to earlier interpretations (Lee, 1983; Hansel, 1984), that the market incentives approach was effective in at least maintaining existing levels of lower income enrollments and in opening the proprietary sector to the economically disadvantaged.

Similarly, McPherson's review of the implementation of MISA provides further support for the proponents of the market-based strategy in achieving public policy goals. While he offers the opinion that the initial MISA legislation represented at best a decision to pursue the lesser of two evils (i.e., tax incentives versus direct aid to middle income students), McPherson emphasizes the value of the information which resulted from the decision to use the direct aid to student approach. It was that information which has contributed, at least partly, to major policy reversals since 1980 in the area of financial aid for middle and upper income students. In these two areas of student financial aid policy (i.e., BEOG and MISA), McPherson's review lends strong support to arguments favoring the use of the commercial market strategy as an effective mechanism for implementing public policy.

On the other hand, the essay also presents a strong counter argument focusing on the dysfunctions of the market system in realizing policy goals related to guaranteed student loans. Although one might have expected the commercial market strategy to be extremely effective in the policy area, McPherson observes that the market approach employed in the current Guaranteed Student Loan (GSL) Program has led to several undesirable consequences. It has (1) failed to provide market tests for the necessity of funding, (2) created a series of perverse incentives for both borrowers and lenders, (3) discouraged innovation, and (4) introduced a bias in Congressional consideration of federal student aid policy. McPherson concludes, then, that the commercial market strategy has been an ineffective tool for implementing guaranteed student loan policy and recommends the restructuring of the policy toward an institutional strategy via the establishment of a national student loan bank.

McPherson's essay begins by expressing the hope that the national policy system can "learn" from its experience with federal student aid policy. So what have we learned? The lessons for this specific policy area seem relatively clear from the essay. But from a broader perspective the debate over the utility of the commercial market strategy as a tool of policy implementation seems further muddled by the apparently contradictory evidence which the study offers.

Perhaps the answer is simply that the policy process is so complex and multivariate that we cannot expect a single strategy to be effective for different policy choices even within a specific policy area, such as student financial aid. Certainly the complexity of joint action by participants with different goals and resources contributes to the difficulty of selecting an appropriate approach for achieving policy goals. But

the problems do not always lie at the strategic level when policies fail, policies also fail as a result of implementation problems. Policies may fail at the strategic level as a result of incorrect (theory failure) policy assumptions about causes and effects or they may fail at the tactical level as a consequence of poor program implementation (program failure). It is not possible to evaluate the adequacy of strategic choices in the case of program failure since the necessary preconditions for success are not met.

In the case of federal student aid policy, McPherson attributes both policy success and failure to the strategic choices made by Congress over the past two decades. On the one hand, the selection of the commercial market strategy for BEOG and MESA seems to have been a wise choice. On the other, the selection of the same strategy for GSL appears to represent a failed strategy (a theory failure). Perhaps, however, the problems with GSL have resulted not from its underlying theory but from its execution. While the broader study from which McPherson draws this essay may well provide some detail about the adequacy of the program implementation of GSL, there is not enough evidence presented here to evaluate whether the problems with GSL resulted from the inadequacy of the commercial market strategy (theory failure) or from ineffective implementation (program failure). McPherson's readiness to abandon the market-based strategy of the GSL program in favor of an institutional solution is surprising. Such a position seems somewhat premature in terms of the current state of analysis and does not appear to be justified by the evidence presented. To abandon a strategy that has generally worked in achieving other student aid policy goals without investigating the possibility of program rather than theory failure seems unwarranted.

McPherson's analysis of student financial aid policy provides clear evidence of the effectiveness of the commercial market strategy as a policy approach. It furthers our understanding of both the policy process in general and of strategic policy decisions in the specific case of student aid financing. We will anxiously await more detailed information on program implementation in this policy area as the results of the broader research effort are presented.

Comment by C. Mark Lawton

President
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I thank Dr. McPherson for analyzing federal student aid programs. His work raises many interesting questions; some I will have time to address today.

First, I would like to make one remark about the federal funding of student financial aid. I don't know where we are as a nation with a trillion dollar deficit. It is a situation that none of us have experienced before and certainly we have no way of knowing the outcome. Regardless, I believe we must invest in higher education no matter what. There is no wiser investment the nation can make than in the education of its citizenry. It constitutes an investment in human capital without peer.

In a study entitled *The Wealth of States: The Political Economy of State Development*, by Roger J. Vaughan, Robert Pollard and Barbara Dyer, dated June 28, 1985, the authors cite Peter Drucker in Chapter 6 to demonstrate the point that such an investment is the most efficient and effective to be made.

> A little reflection will show that the rate of capital formation to which economists give so much attention is a secondary factor . . . . The basic factor in an economy's development must be the rate of 'brain formation'--the rate at which a country produces people with imagination and vision, education, theoretical and analytical skills. (Drucker, 1977, P. 63)

A country or state produces such people through its educational system. Education is essential to our economy; it is critical to the assurance of an open, free, tolerant and prosperous society. Take away our educational system and you take away the American dream and drive. A democracy can only flourish if its citizens are informed and aware, that is to say, educated and educable. America is unique. We try to provide broad-based education and that is costly no matter how you cut it.

The first part of Dr. McPherson's paper discusses the effectiveness of student aid programs in promoting the college enrollment of lower income and disadvantaged students.

I feel he points out several important variables not considered by analysts who claim that federal aid programs have had little or no effect in increasing educational opportunities for disadvantaged populations. In addition to the points he has raised, I would like to add that in New York State, the number of minority students, most of whom are from low income families, increased from approximately 72,000 in 1974 to 103,000 in 1980. Although I wish the growth had been much greater, I suspect that without federal aid not only would there have been zero growth but probably a decline in minority enrollments.

I also strongly believe that the growth in minority enrollments is tied to a strong state student financial aid program. The federal government sets the tone and philosophy on student aid policies. Without a strong federal commitment and belief in higher education for all, state and institutional efforts may not be sufficient to cover the expense of educating low income students. The data in New York State support this statement. From 1980 to 1984, while federal aid declined, minority enrollment remained the same. Without the strong support of the State and institutional student aid programs, minority enrollments probably would have decreased. Nationally, from 1981 to 1984, independent institutions increased the amounts of institutionally-provided student aid from $500 million to more than $2 billion.

Dr. McPherson also raises several interesting issues in the second part of his paper. I will comment specifically on the following topics: Student Aid vs. Institutional Aid, Proprietary Institutions, Tax Credits vs. Aid Expenditures, and Guaranteed Loans vs. a Loan Bank.

In the case of Student Aid vs. Institutional Aid, Dr. McPherson agrees that the federal government's decision to fund students instead of institutions was the correct way to go. I do not argue that student aid has advantages, but that does not mean one type of support precludes another.

Institutional aid provided by New York State in the form of Bundy Aid has been well used, well accounted for, and perhaps partially responsible for the rise in minority enrollments in New York's independent sector. Institutional aid does not negate the major effort--student aid. Institutional aid allows institutions to do creative and worthwhile programs and projects.

Dr. McPherson states that "direct aid to students gives institutions a straightforward incentive to respond to those students' demands." I'd like to point out that this is only true to the extent that this aid is sensitive to the cost the student must pay. The major federal aid program, Pell Grants, covers 60 percent of the cost of education at many low-priced institutions, but only 21 percent of the cost at the average-priced independent college. Therefore, I believe we must be careful in suggesting that the federal aid programs give students total flexibility in the "educational marketplace."

This leads me to my next point, the growth of the proprietary sector. The burgeoning enrollments in the proprietary sector can no longer be ignored. This point was the golden nugget in Dr. McPherson's paper for me. No doubt, direct federal student aid accounted for some of this growth, but I have a hunch that it is more than that. I believe we need to search into the reasons why lower income students are turning to these institutions for their education. Do these students see a way out of poverty through quick attainment of a marketable skill? The growth of the proprietary sector is a fascinating sociological phenomenon, one which can no longer be ignored by public policy makers and higher education planners.

Regarding Tax Credits vs. Aid Expenditures, I again do not believe that one precludes the other. Tax credits could have been made income sensitive with the focus placed on assisting middle income families. In my opinion, there is nothing wrong with helping middle income people. Education for their children should also be attainable, regardless of the price of the institution. Grant funds should go to the neediest students first, with remaining grant funds going to middle income students along with loans, jobs, and yes, tax credits. But I am afraid that in the present political and philosophical climate, tax credits are a dead issue.

The Middle Income Student Assistance Act of 1978 was passed by Congress to help these students and it did. Is that bad? I don't think so. It went too far and there were some abuses--abuses corrected in the Reauthorization Act of 1981. Today, federal policy seems to be moving away from these students. Policy makers must be careful not to reduce and eliminate access and choice for middle income students as well as disadvantaged students.

Finally, the future of the Guaranteed Student Loan Program is of great concern to us all. Close to $50 billion has been lent to students since 1966. This program alone has provided more funds to students than all other federal student aid programs combined. Current concerns about the cost and default rate in the program are triggering drastic suggestions from some members of Congress. We must remind people that a program that will cost the government approximately $3.8 billion in 1985 allows millions of students to obtain a higher education at small cost to taxpayers, when compared to the total federal budget. And, that if savings are to be made, there are areas in the program that can be changed to realize savings. For example, making loans 100 percent need-based will save money without causing great hardships or disarray in the program. Secondary markets should be examined and used to their maximum.

Getting to Dr. McPherson's last suggestion, I am not convinced that establishing a national loan bank is a good idea. In fact, I am concerned that such a bank would seriously limit the amount of funds available for students to borrow. This bank would become subject to the allocation process that has drastically eroded other federal student aid programs. Once the loan system was set up to draw upon public money instead of private funds, we should almost certainly be faced with caps on the aggregate pool of funds.

Obviously, banks make a profit on the program. If they did not, they would not participate. Is it an exorbitant profit? I don't think so. The profit to banks on Guaranteed Student Loans is about one percent of the three and one-half percent special allowance they receive. The other two and one-half percent covers administrative costs. Banks musts be well organized and efficient to make certain that they make a profit after their operating costs. Would the federal government be as efficient? Higher edu-

cation policy makers need to be extremely cautious in moving toward any type of a national loan bank.

In closing, I would like to re-emphasize the importance of an educated citizenry. Education is the primary tool of economic development. Much of our policy-making energy has been focused on infrastructure improvements, tax reduction, and various employment development incentives.

There is danger that the importance of all parts of the system are not being recognized. Most particularly, I am concerned that the importance of higher education is not fully understood. I am convinced that the continued economic growth and well-being of our nation is interconnected with the growth and excellence of its higher education institutions. The two cannot be addressed independently--one cannot survive without the other. Colleges must be more than just a training ground for specific jobs. Our nation needs well-rounded individuals who can create, contemplate, and have the vision to resolve the broad issues that face us.

I again thank Dr. McPherson for devoting his time on this topic of such concern and importance to all of us, and I thank you.

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